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In the Supreme Court of the United States

October Term, 1962

HENRY A. KUCKENBERG, TRADING AS KUCKENBERG TRANSFER; HAMLIN KUCKENBERG, TRADING AS KUCKENBERG TRANSFER; AND LAWRENCE W. KUCKENBERG, TRADING AS KUCKENBERG TRANSFER; PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 828

HENRY A. KUCKENBERG, TRANSFEREE; HARRIET KUCKENBERG, TRANSFEREE; AND LAWRENCE W. KUCKENBERG, TRANSFEREE; PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 152–187) are reported at 35 T.C. 473. The opinion of the Court of Appeals (Pet. 12–23) is reported at 309 F. 2d 202.

JURISDICTION

The judgment of the Court of Appeals was entered on October 11, 1962 (Pet. 23; R. 274). Petition for rehearing was denied on November 16, 1962 (R. 275). The petition for a writ of certiorari was filed on February 14, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Pursuant to a plan of complete liquidation, Kuckenberg Construction Company, an Oregon corporation, sold and assigned three construction contracts, the income from which had been fully earned, to an independent purchaser for $327,000. The corporation was on the cash method of accounting. The questions are:

1. Whether the Commissioner properly required the corporation to recognize as ordinary income the proceeds from its sale or assignment of these completed construction contracts?

2. Were the petitioners, who owned all the stock of the Kuckenberg Construction Company and received all of its assets in complete liquidation, liable, as transferees, for unpaid income taxes upon amounts earned by the corporation prior to liquidation and dissolution?

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 337, 446, and 6901 of the Internal Revenue Code of 1954 appear in the Appendix, *infra*, pp. 10–12.

STATEMENT

This case involves the liability of petitioners as transferees of the assets of Kuckenberg Construction Company, a dissolved corporation, for deficiencies in income taxes due from that corporation for the taxable years 1954 and January 1 to December 7, 1955.

From its incorporation under the laws of Oregon on December 6, 1949, until January 14, 1955, the

Knickerbocker Construction Company was engaged in the heavy construction business, consisting primarily of road building and related work. Petitioners were the officers and directors of the corporation, and at all pertinent times the outstanding capital stock of the corporation consisted of shares of common stock all of which were owned by the petitioners. The corporation employed the cash basis method of accounting, and its federal tax returns were filed on this basis (Pet. 13; R. 43–44, 158).

On December 17, 1954, the board of directors of the corporation adopted, and the stockholders approved, a plan of complete liquidation of the corporation (Pet. 13–14; R. 44, 159–160). On December 27, 1954, pursuant to the plan, the corporation sold and assigned three construction contracts to David B. Simpson for $327,000, payable in installments (Pet. 14; R. 48, 163). Simpson was not in the construction business, but was a real estate agent and operator (Pet. 14; R. 163). The construction company had completed the work which it was required to perform in connection with these contracts, but settlement had not been made at the time its board of directors decided to dissolve the corporation (Pet. 14; R. 153). In the sale and transfer of the contracts, the corporation warranted that the purchaser would receive substantial specified sums in excess of any expenditures which he might have to make under the contract. The corporation also indemnified the purchaser from any liability resulting from the contract and the activities of the corporation under the

contracts prior to the sale and transfer (Pet. 14; R. 62, 87–88). In the agreements of assignment with respect to the contracts, the corporation guaranteed that each contract "has been or will be fully performed in accordance with its terms" (Pet. 14; R. 89–96). By agreement, petitioner Henry A. Kuckenberg also warranted personally that the purchaser, Simpson, would receive at least $327,000 from the three contracts in excess of any expenditures by the purchaser under those contracts and agreed that upon demand Mr. Kuckenberg would pay any deficit existing on October 1, 1955 (Pet. 14; R. 98–100).

On January 25, 1955, the liquidation of the corporation was accomplished. Liquidating distributions were made to the petitioners. The corporation was left without any assets after December 7, 1955. On December 7 the corporation filed articles of dissolution with the Oregon Corporation Commissioner pursuant to Oregon law, and on the same date the Corporation Commissioner issued his certificate of dissolution (Pet. 14–15; R. 160, 162–163). The assets received by the petitioners upon the liquidation of the corporation were transferred by them to a partnership among themselves, which continued the operation of the business previously carried on by the corporation (Pet. 12; R. 161). The Kuckenberg corporation did not report any taxable income from the three construction contracts in issue. On its tax return it reported its revenues from these contracts as if received in a nontaxable transaction (R. 164).

On April 25, 1958, notices of deficiency in the income taxes of Kuckenberg Construction Company for

the taxable years 1954 and January 1, 1955, to December 7, 1955, were issued to the petitioners as transferees of the assets of the corporation (Pet. 15). In deficiency proceedings the Tax Court held that the petitioners are liable in equity as transferees for the deficiencies in tax due by the corporation for periods prior to the distribution. Since the transferor corporation had been dissolved and all of its assets had been distributed to its stockholders, the Tax Court held that it was not necessary for the Commissioner to issue a deficiency notice or proceed against the transferor corporation before proceeding directly against the transferee-stockholders, as he did here (R. 168-175). With respect to the tax liability of the transferor corporation, however, the Tax Court held that the $327,000 gain from the sale of the three construction contracts to David B. Simpson was not to be recognized because the contracts represented "property" which "is not excluded from the nonrecognition of gain or loss provisions of section 337(b)" (Pet. 12, 15; R. 178).

The Court of Appeals affirmed the holding that petitioners are liable as transferees for the taxes payable by the Kuckenberg Construction Company (Pet. 12-13, 19-23). It reversed the Tax Court's decision that the corporation recognized no gain upon the sale or assignment of the three completed construction contracts, holding that the Commissioner properly exercised his authority under Section 446(b) of the 1954 Code to require the corporation to account for the gain on these contracts.

ARGUMENT

The decision of the Court of Appeals in this case is based upon well-established principles of federal tax law and is clearly correct. There are no conflicting decisions, and there is no reason for further review by this Court.

1. Amounts earned for services rendered by a taxpayer have always been treated as ordinary income whether they are realized, on the one hand, by payment of wages or a contract obligation or, on the other, by sale of the "property" right to receive payment. Because ordinary income cannot be changed into capital gains by the simple device of an anticipatory sale of the right to receive the amounts due, the courts have long accorded the proceeds of such a sale the same ordinary-income treatment as would be accorded receipt of the earned sums in a transaction not involving any sale or exchange. These rules plainly apply to the present case unless they are altered in some way by section 337 of the Internal Revenue Code of 1954. It is undisputed that prior to December 17, 1954, the Kuckenberg Construction Company had completed all work which it believed was required under the three construction contracts here in question and had earned the income from them. The corporation did not seek or await payment in the normal course but, pursuant to a plan of liquidation adopted on December 17, 1954, assigned its rights under the contracts to a third party on December 27, 1954, for a discounted price of $27,000, payable in installments (Pet. 13-14; R. 48, 163). The assignee

was not in the construction business but relied upon guarantees of performance, warranties, and indemnification agreements from the corporation, and one of the petitioners (Pet. 14; R. 62, 87–96, 98–100). Under these arrangements the corporation remained responsible for its performance of the construction contracts but received the proceeds of performance earlier than otherwise by discounting its contract right with a third party. The receipt of the proceeds of such an anticipatory sale of the right to income earned by services has always been treated as ordinary income to the selling taxpayer.

This result is in no way altered for liquidating corporations by section 337 of the Internal Revenue Code of 1954 which provides for the nonrecognition of gain upon sale by a liquidating corporation of certain noninventory property. Section 337 is plainly and intentionally limited so as to preserve the general requirement of recognition by the liquidating corporation of gain from services or from the sale of inventory. The present case does not involve the nonrecognition provisions of section 337 unless petitioner is correct in contending that despite this careful limitation the statutory provisions can be extended by every cash basis taxpayer to apply to gain from services or ordinary sales of inventory by the simple and readily available device of selling the contract right to be paid or the account receivable. Every court that has considered this question has correctly rejected petitioner's contention. *West Seattle National Bank of Seattle* v. *Commissioner*, 288 F. 2d 47 (C.A.

9th); *Citizens Federal S. & L. Ass'n of Cleveland* v. *United States*, 290 F. 2d 932 (C. Cls.); *Family Record Plan, Incorporated* v. *Commissioner*, 309 F. 2d 208 (C.A. 9th), petition for certiorari pending (No. 874, this Term); *Central Building & Loan Association* v. *Commissioner*, 34 T.C. 447. See also *Williamson* v. *United States*, 292 F. 2d 524 (C. Cls.), and see Rev. Rul. 59-120, 1959-1 Cum. Bull. 74.

2. Petitioners further contend (Pet. 6-7) that they are not liable as transferees of the Kuckenberg corporation because under Oregon law "transferee liability may be imposed only upon perfection of the claim as a definite obligation of the transferor." In *Commissioner* v. *Stern*, 357 U.S. 39, this Court held that the substantive liability of a transferee depends upon state law. However, in the *Stern* case this Court recognized that the procedures which the Commissioner must follow to collect taxes from a transferee are those set forth in the transferee provisions of the Internal Revenue Code (see Section 6901 of the 1954 Code, Appendix, *infra*, pp. 11-12). Both courts below reached the conclusion that Oregon law imposes substantive transferee liability upon the sole transferees of all the assets of a liquidated and dissolved corporation (Pet. 20-21; R. 171). Petitioners now apparently make no contrary contention. Their sole contention, that the Commissioner was required to establish the liability of the defunct transferor corporation before proceeding against them as transferees, relates to the procedure for enforcing

transferee liability. Such procedures are not governed by state law but by the provision of the Internal Revenue Code (Section 6901) with which the Commissioner complied.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL, 1963.

APPENDIX

Internal Revenue Code of 1954:

SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) *General Rule.* If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) *Property Defined.*

(1) *In general.*—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or ex-

changed before the date of the adoption of such plan of liquidation.

(2) *Nonrecognition with respect to inventory in certain cases.*—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

* * * * * * *

(26 U.S.C. 1958 ed., Sec. 337.)

SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING.

(a) *General Rule.*—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) *Exceptions.*—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

* * * * * * *

(26 U.S.C. 1958 ed., Sec. 446.)

SEC. 6901. TRANSFEREE ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the

case of the taxes with respect to which the liabilities were incurred:

(1) *Income, estate, and gift taxes.*—

(A) *Transferees.*—The liability, at law or in equity, of a transferee of property—

(i) of a taxpayer in the case of a tax imposed by subtitle A (relating to income taxes),

* * * * *

in respect of the tax imposed by subtitle A or B.

* * * * *

(b) *Liability.*—Any liability referred to in subsection (a) may be either as to the amount of tax shown on a return or as to any deficiency or underpayment of any tax.

* * * * *

(h) *Definition of Transferee.*—As used in this section, the term "transferee" includes donee, heir, legatee, devisee, and distributee, and with respect to estate taxes, also includes any person who, under section 6324(a)(2), is personally liable for any part of such tax.

* * * * *

(26 U.S.C. 1958 ed., Sec. 6901.)